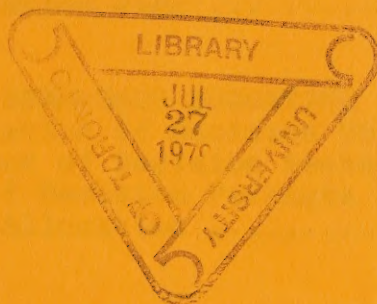


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FINANCIAL PROCEDURES

BULLETIN 4

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ZERO - BASE BUDGETING



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Ontario Ministry of Intergovernmental Affairs

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INTRODUCTION

Zero-base budgeting is a disciplined method of establishing financial priorities which is gaining increasing popularity. As part of the management process, it makes it easier for all levels of management to appreciate the nature of their operations and thereby make decisions predicated on real alternatives. It has emerged from an effort to tighten the relationship between justification of service levels and allocation of resources.

This bulletin is intended to describe zero-base budgeting in general terms. It is not necessarily intended to take an advocacy position -- that every Ontario municipality should implement this management approach. Each municipal organization is unique, and many factors must "fall into place" before this technique can be implemented successfully. This publication is designed to acquaint you with the basics of zero-base budgeting so that you can determine its appropriateness to your municipality.

For those desirous of a more in-depth evaluation, you might refer to some of the articles and books outlined in Appendix A attached to this publication. As this new budgetary management approach becomes more prevalent in Canada, a greater number of resource documents highlighting Canadian experiences are gradually appearing.

BACKGROUND

Zero-base budgeting was formally developed and installed in 1969 by Texas Instruments Incorporated of Dallas, Texas. Its originator, Peter Pyhrr, published an article about the company's approach in the 1970 November-December issue of the Harvard Business Review. Jimmy Carter read this article and recognized that it could be an effective tool for understanding and controlling the State of Georgia budget. In Georgia, the zero-base budgeting process, among other things, revealed 10 beekeepers were on the payroll, but no one knew why.

Since these pilot ventures, a diverse range of enterprises have implemented zero-base budgeting or modified versions. The earliest Ontario experiments were probably Canadian Broadcasting Corporation (Ottawa), Westinghouse Canada Limited, and McMaster University (both in Hamilton). McMaster introduced zero-base budgeting in 1975 when they were facing a budgetary deficit of \$2.5 million on a \$40 million budget. Within two years they were able to bring their budget in balance, which was their prime objective.

In the local government sector, a number of Ontario municipalities have implemented zero-base budgeting, for example, the Cities of Cambridge, Hamilton, Guelph, Peterborough, Thunder Bay and Sudbury. In addition, a number of other municipalities are currently considering its introduction for 1980.

WHAT IS ZERO-BASE BUDGETING?

Basic Concept

Zero-base budgeting is a highly structured process requiring each department head and his subordinates to justify in detail their entire budget request rather than adding on an increase to what was spent last year. To do this, each manager must analyze every program under his jurisdiction, identify different levels of service that could apply, quantify the costs and effectiveness of each level of service, and justify the continuation of each activity. This means that every activity must be examined to ensure that it is still necessary in terms of organizational objectives, and if so whether it can be done more effectively.

However, the zero-base concept does not necessarily imply one must start with a zero dollar budget allocation. The term "zero-base" was coined to emphasize that no activity would automatically receive an allocation of funds without question. In the majority of government implementations, it is a matter of identifying the critical point below which an activity or program loses its validity or effectiveness. Once this minimum level of effort is identified managers then develop self-contained incremental "decision packages" for each activity to highlight the costs and benefits of successive increases in service.

After the "decision packages" have been identified, they are then grouped systematically into an array in order of decreasing benefit relative to meeting the municipality's objectives. The merits of all activities in all departments are weighed one against the other. A selected level of expenditure is then matched against the final ranking (based on decreasing priority), and if funds are not sufficient to offset the entire listing,

lower priority items are left unfunded until the cumulative total exactly matches the level of funding available. The final priority list, balanced with available resources, then becomes the budget.

Zero-base budgeting is, therefore, a sharp break with tradition. It discontinues the customary approach where officials tend to regard the past year's budget as a starting point and add to it more projects and the personnel required, with limited justification. The budget review no longer regards the previous level of servicing as fixed or unavoidable. In effect, zero-base budgeting puts previously authorized expenditures on an equal footing with requests for additional funds.

Essentials

The essentials of the zero-base budgeting system therefore are the identification of objectives, the evaluation of all existing activities, the identification and evaluation of alternatives and of new activities, ranking of activities according to priorities, and the establishment of a consolidated operating plan and the associated level of taxation.

In regard to other planning and budgeting systems, such as, management by objectives (MBO), planning-programming-budgeting (PPB) and performance budgeting, zero-base budgeting extracts certain characteristics from each and integrates these elements to create a unique framework. These techniques include incremental analysis, the setting of goals and objectives, analysis of alternatives, cost/benefit analysis and performance measurement. In other words, the zero-base approach is not entirely original -- only the formalization of the process.

Management Process

Zero-base budgeting is more than a budget process. It involves managers at all levels and includes objective setting, program evaluation, and operational decision-making, whereas traditional budgeting procedures often separate these management aspects. It vastly enhances motivation at lower and middle management levels.

Zero-base budgeting is a management instrument that recognizes the decision-making benefits attainable from a simultaneous organization-wide examination of all activities. Its ability to stimulate creativity, provide analytical support, coordinate operations, facilitate the monitoring of performance, et cetera, is discussed later in this bulletin. In many respects to adopt zero-base budgeting is to call for management reform.

WHERE DOES ZERO-BASE BUDGETING APPLY?

Public Sector

Zero-base budgeting is applicable to discretionary cost areas in which services and administrative support functions are the primary outputs. It is this characteristic of zero-base budgeting that has attracted the interest of government officials, as many expenditures of government are discretionary in nature (they can be varied, deferred or accelerated on the basis of specific management decisions).

Zero-base budgeting should be expected to produce greater insight into the more detailed operations actually carried on within municipal departments and should provide a much sharper focus on relative priorities. It should be recognized that it has no affect on fixed

or unavoidable current commitments, such as, debt charges or long-term service agreements.

Its service level options should give a clearer picture of alternative courses of action. In addition, zero-base budgeting may assist organizational reviews since a rational analysis of activities should highlight areas of overlapping jurisdiction, possible duplication of effort and redundant operations.

It is also noteworthy that in some instances where zero-base budgeting is employed, it is used to augment the conventional budgeting process of the organization, for example, the Ministry of Revenue utilizes zero-base budgeting as a managerial planning device, but uses a "management by results" approach for its official budget.

Private Sector

Private corporations may use it for service and support activities, such as research and development, production planning, engineering and marketing and general office activities, but it is not appropriate for production level expenditures which are normally proportionate to sales volume. Expenditures on direct labour and materials are not truly discretionary, because there usually is no benefit from increasing these expenditures without some correlation to anticipated sales.

In production operations the emphasis is on minimizing unit costs, with the budget developed by multiplying units of output by standard unit costs. Where standard costs are determinable, those costs associated with inputs should be controlled through the use of standard costing procedures.

General Exceptions

There are no absolute formulae which, if applied, reveal a need for this process. However, from those having considerable experience with this concept, it would appear that certain conditions may preclude a successful implementation. These situations are summarized below:

- A management that is not committed to a need for change. They must be willing to spend the time to provide guidelines and direction.
- A sense of management trust does not prevail. This is a participative process requiring enthusiasm and hard work at all levels of the organization.
- The financial environment is stable and management is confident that its resources are properly allocated.
- The enterprise is small and therefore can informally manage its organization.
- If other major changes are currently in progress, the organization may be unable to devote the attention that is needed for a successful zero-base approach.

ESSENTIALS FOR SUCCESS

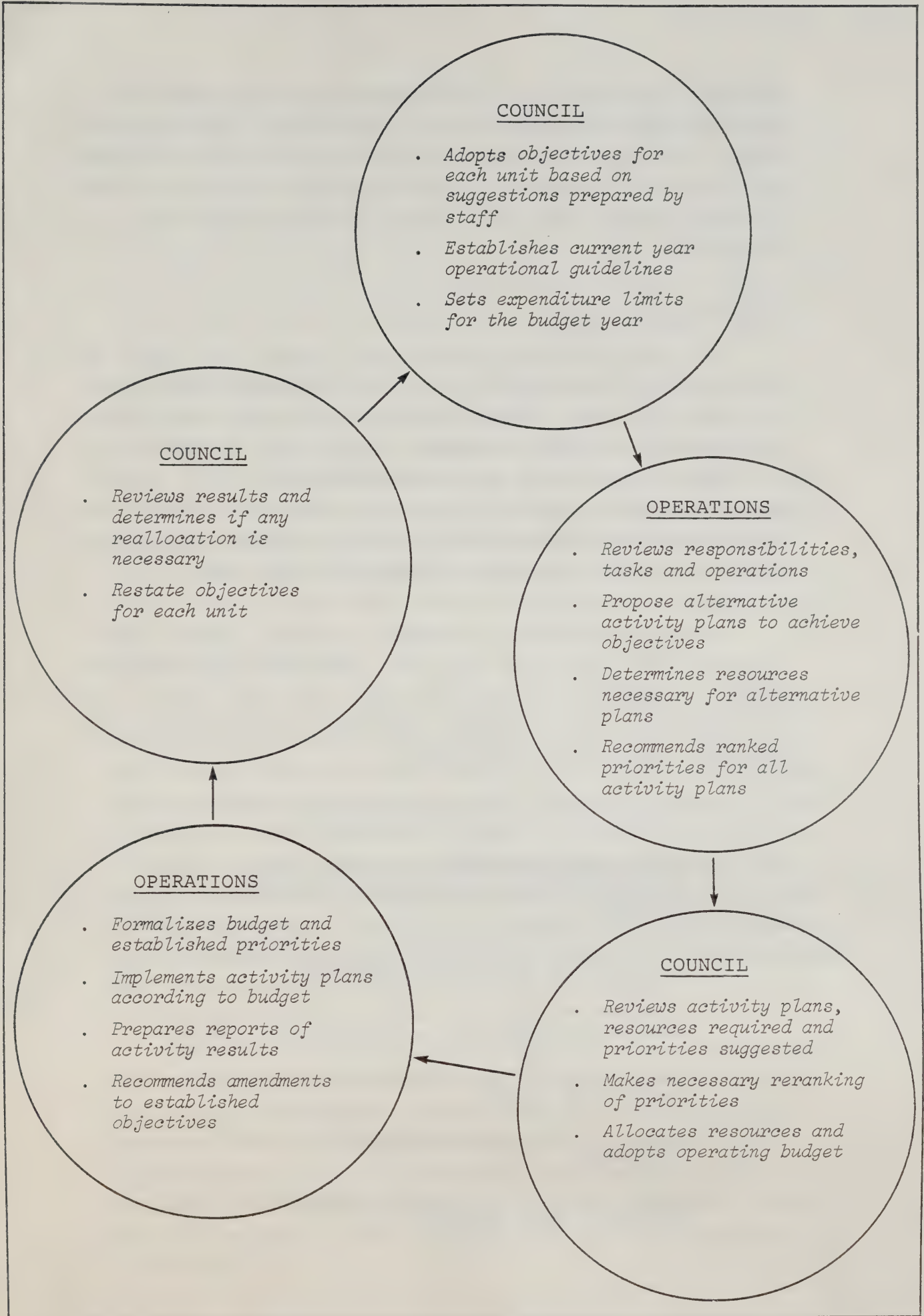
Commitment By Management

Although zero-base budgeting is often perceived as a budgeting technique, it should be thought of as a decision-making tool. Furthermore, since ultimate authority and accountability for decisions rests with council and/or senior management, it is they and not the treasurer by himself who must assume total responsibility to make the process happen. Little can be achieved until they become committed to zero-base budgeting. Council must bear the responsibility for deciding whether the proposed changes are practical

and whether the municipality should in fact accept them or whether they carry unacceptable risks.

The commitment to provide the required leadership should not be taken lightly. A council should ask itself the following questions:

- Are we prepared to review, often in some detail, many decision packages? This is particularly true in the first year, when everything will require a thorough assessment that has often not been made for many years, if ever.
- Are we prepared to assign our best talents to administer the process? Zero-base budgeting must be one of the municipality's leading priorities if it is to work properly.
- Is the management environment ready to operate openly in an analysis-oriented atmosphere as opposed to a management style characterized by decisions based on past experiences and intuition?
- Is there a willingness to communicate objectives, strategies and problems to all levels of management to maximize resources that will generate innovative alternatives? Full success of the system requires the support and participation of managers at all levels. A condensed outline of this interactive process is illustrated on page 9.
- Is council ready to implement a change that requires considerably more effort and may take two or three years to achieve the full benefits? Measurement of service levels has proven to be one difficulty and most users report an increase in time to prepare support documentation, and the involvement of significantly more personnel in preparation of the budget.
- Is the municipality prepared to place greater emphasis on budget monitoring in the future? One advantage of zero-base budgeting is its potential to measure in more detail variances between actual performance and original budget allocations.



The main ingredient of this process is the interaction of elected and staff officials in negotiating decision packages, getting additional information if needed for budget decisions and reaching agreement on what is to be accomplished if reductions are made or program expansions approved.

Defining Objectives

The first step in structuring a zero-base budget is to establish its objectives. Many organizations attempt to establish their objectives using zero-base procedures and forms developed elsewhere. The effect may be a lot of unnecessary effort redesigning someone else's forms and procedures created to meet an entirely different set of objectives. The process should preferably be customized to satisfy the specific needs of each user.

Setting objectives normally involves informal meetings between appointed officials who will administer the budget as well as elected officials who will approve the end product. The following highlights some of the more frequent objectives developed:

- establishing a more credible operating budget for the forthcoming year,
- establishing a budget process that requires greater involvement of line managers,
- instituting a cost reduction program to accommodate declining revenues,
- diagnosing what actually occurs so as to refine policies and set long-range goals,
- validating the feasibility of existing long-range plans,
- auditing the effectiveness of existing programs,
- providing a data base to restructure the existing organization.

While one might consider all of these as desirable objectives, it is better to restrict your efforts to two or three key objectives. To attempt to install the perfect system all at once may be so disruptive that the idea will never see the light of day. Before implementing these changes, ensure that all participants understand the objectives set and appreciate that no others will be pursued until some degree of accomplishment can be demonstrated.

Another fundamental decision required, early in the discussions, is the comprehensiveness of the zero-base budget process. There is the possibility of including only some of the departments or only certain expenditures (such as personnel costs). Generally, initial implementation excludes so-called "fixed" expenses, such as debt charges or long-term lease agreements, due to the lack of short-term control and discretion over these expenditures.

Orientation Seminars

While few people will argue the logic that permeates the zero-base methodology, one must recognize that it can produce psychological effects as a result of its emphasis on participatory management, horizontal and vertical communication, and detachment from procedures followed in the past. It is therefore important that council and senior appointed officials establish precisely what zero-base budgeting is intended to achieve and explain these goals through the use of seminars conducted by individuals who know the municipality and its problems.

The initial seminars should concentrate on explaining to councillors and managers the history, concepts, principles and terminology of zero-base budgeting with later sessions used to stress the mechanics of establishing departmental goals and objectives, and setting work-load measures. Having well-informed personnel may not guarantee full support, but it should allay any preconceived misgivings.

Consultants

All of the Ontario municipalities (as listed on page 2) that have adopted zero-base budgeting, have used management consultants to varying degrees in its development and initial implementation. The system design and staff training demands can be considerable during the first year. Using consultants to assist in developing an operating budget manual, design forms, write-up procedures, and advise on the preparation of decision packages could be extremely helpful in keeping the exercise on schedule.

One final value of using competent consultants is that they will be impartial and objective. By working with department heads they, as outsiders, can more likely bring about an acceptance of extensive change than could an internal group under the control of one of the existing department heads.

Implementation Plan

The adoption of zero-base budgeting also necessitates the design of a relatively extensive manual, although this need not be complicated. Basically, the manual explains the concept so that it can be understood at all management levels, indicates how the processes are to be implemented by each budget unit, how the forms are to be completed and how and when they are to be submitted. An essential part of drafting the system is the establishment of a calendar of events, a series of deadlines, beginning with preparation of reports at the lowest levels of management on up, to final council approval.

Before the actual process commences, council and senior management should develop policy assumptions such as spending guidelines, salary structures, provision for inflation, and so on which can be used to gauge the extent of feasible alternatives. This should avoid staff at the lower levels

presenting unrealistic scenarios of increased service levels without some regard to fiscal constraints that exist.

FEATURES OF ZERO-BASE BUDGETING

Although the specifics differ among organizations, there are four basic technical steps to the zero-base approach:

1. Identifying and defining decision units.
2. Developing decision packages.
3. Ranking decision packages to form the appropriations request.
4. Allocating resources and finalizing the detailed operating budget reflecting those decision packages approved.

Identification of Decision Units

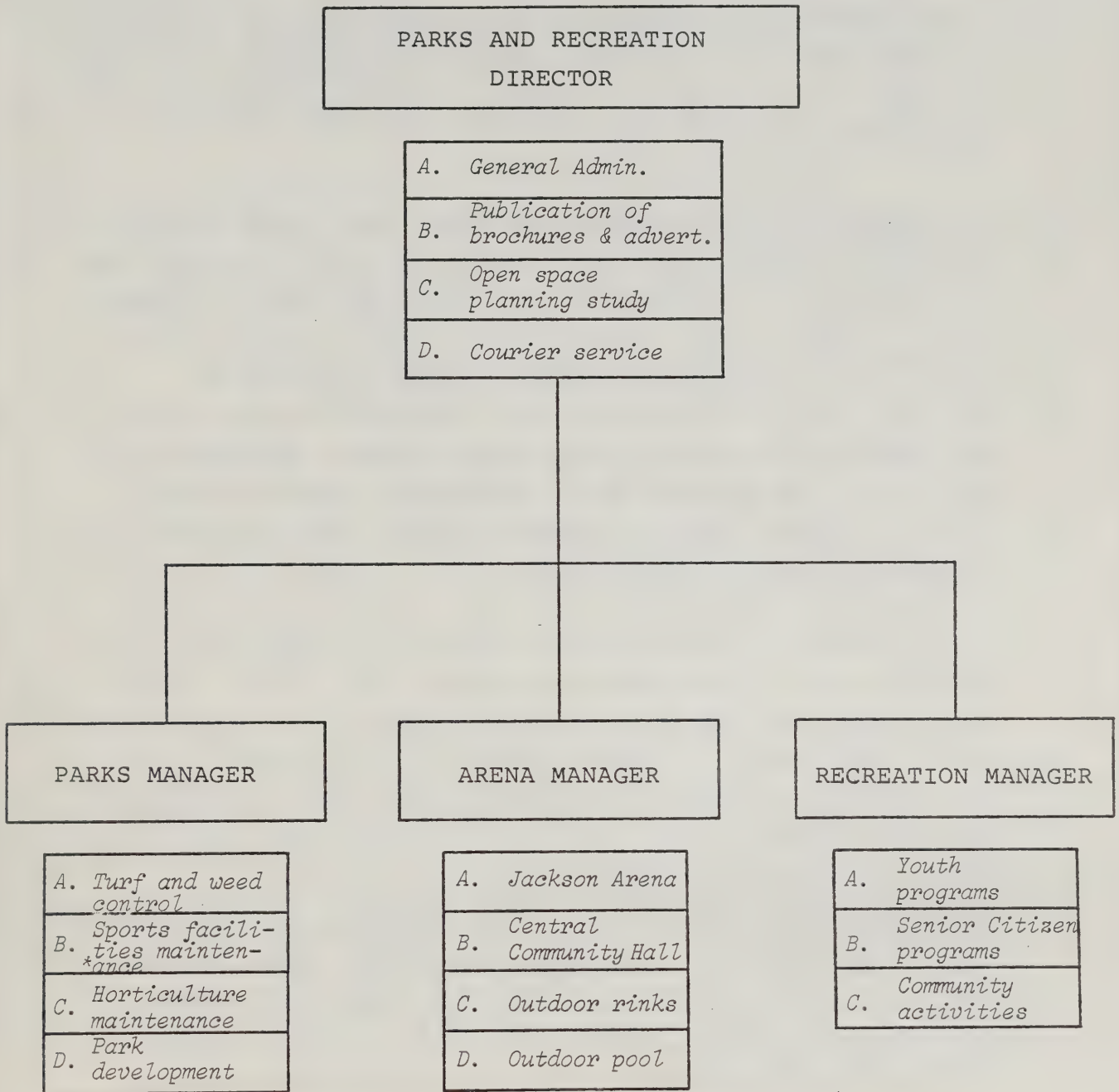
The implementation process starts with the identification of decision units. A decision unit is a tangible activity or group of activities for which a single manager has the responsibility for successful performance. There is no universal method of identifying a decision unit. For example, a decision unit may be a traditional cost centre, such as a water treatment plant. A decision unit may relate to a group of people, such as non-uniform staff in the fire department. Services provided or received, such as tax billing or a particular recreation program or facility may be the focus of a decision unit.

The common feature of any decision unit is that there should be a fairly obvious measurable output resulting from the resources committed to the unit in the budget year. Therefore, a constraint on how a decision unit is defined is that there must exist either in the accounting system or in an informal reporting system a means of

measuring physical progress and resources consumed on a systematic and periodic basis. If the municipality's accounting system now only identifies costs on a departmental basis, then revisions to the extent of analysis will be necessary if decision units are defined at a lower level. For example, building inspection and by-law enforcement are often contained within one departmental jurisdiction. Council may wish to correlate building inspection expenditures with changes in construction activity; to achieve this, building inspection should be designated as a separate decision unit and the accumulation of accounting information modified to reflect the inherent costs of this activity. On page 15 a hypothetical example has been prepared to illustrate the nature of decision units.

The number of decision units identified for analysis purposes will depend on the size of the municipality's operations, extent of alternatives available, the level at which meaningful decisions can be made and time constraints existing. For example, there is little point in establishing a decision unit for an activity that is interdependent on another activity or for an activity which council has minimal power to change. Because of the time necessary to develop various alternatives, municipalities not accustomed to in-depth financial analysis and decision-making at lower organizational levels, may want to limit the number of decision units to be considered. However, in subsequent years, as managers become more adept in zero-base budgeting, they can effectively expand the process into lower organizational levels and handle the larger volume of packages.

EXAMPLE OF DECISION UNITS DETERMINED FOR
A PARKS AND RECREATION DEPARTMENT



*Expenditures distributed to Arena Manager's decision units

A. }
 B. } Represents "decision units"
 C. } established for this
 D. } example.

Development of Decision Packages

A decision package is a form or document that presents a comprehensive picture of one way of performing an activity (defined decision unit). There may be several decision packages for each decision unit -- each representing a successive increment level.

The key to the zero-base process lies in the identification and evaluation of alternative courses of action for each activity. Managers must initially identify a minimum level of spending for each decision unit -- often 65% to 75% of current operating levels -- and then develop service improvement alternatives highlighting the costs and benefits that will occur from increased funding of the activity. The minimum level of spending would be that level of effort which if reduced further would necessitate discontinuance of the activity.

A sample of three decision packages, pertaining to one activity, are illustrated on pages 18, 19, and 20. These are offered only as an example, for there is no such thing as an ideal format. Formats should be developed to suit the particular needs of each municipality and incorporate only the elements that are valid and useful for decision-making purposes. If managers have an opportunity to verbally present and discuss their decision packages, the package documents can be reasonably short. When decisions are to be based primarily on what is displayed in each package, the package formats must necessarily be longer to communicate adequately the analysis and recommendations.

Generally, as a minimum, all decision packages will incorporate the following:

- a definition and description of the activity for organizational identification,
- a rank number identifying the order of priority of the package (provide flexibility for reranking),
- the purposes and objectives of the activity,
- performance and work load measurements,
- alternative ways of performing the activity,
- short and long-term cost information related to the package, and
- benefits to be achieved from the package and the risks of not acting.

The order of items is optional, but constructing the forms so that certain information is to be automatically included, in specified sections, establishes uniformity and encourages managers to develop the data required. The incorporation of data regarding the manpower involved is a valuable addition.

Establishing objectives and performance measurements are probably the most difficult aspects of this exercise. A good statement of objectives tells the reader what will be achieved, when it will be achieved, how it will be achieved and how he will know it has been achieved. Setting equitable performance measures is a complex art when applied to service operations as government. They are usually provided on a quantitative basis (tons of refuse collected, number of fire call responses, miles of road graded) and a qualitative basis (is the quality satisfactory?, are we serving our market?, are we meeting deadlines?).

ACTIVITY <i>Residential Refuse Collection</i>		DEPARTMENT <i>Public Works</i>	DATE <i>12/2/78</i>	LEVEL <i>1 of 3</i>			
PREPARED <i>J. Abercrombie</i>	APPROVED <i>A. Fritz</i>	SECTION <i>Sanitation</i>	RANK BY	2 <i>JA</i>	8 <i>AF</i>		

PURPOSE OF ACTIVITY:
Collection of solid waste from households in urban areas and from four transfer stations in rural areas.

PERFORMANCE MEASURES	1977	1978
<i>Number of homes served</i>	<i>3,670</i>	<i>3,740</i>
<i>Collection per week</i>	<i>2</i>	<i>1</i>
<i>Tons of refuse</i>	<i>7,340</i>	<i>7,480</i>
<i>Collection cost per home</i>	<i>\$36.03</i>	<i>\$23.03</i>

DESCRIPTION OF ACTIVITY:
This minimum level employs two 2 man crews to collect refuse once per week in the more urban areas. Normal pickups are scheduled on a 4 day week basis. On Mondays special pickups and maintenance of transfer stations. Service agreement with Sani-Services Ltd. delivers 5 cu. yd. bins to dump site each Monday.

RESOURCES REQUIRED	1977 ACTUAL	1978 THIS PACKAGE
<u>PERSONNEL</u>		
<i>FULL-TIME</i>	<i>8</i>	<i>4</i>
<i>PART-TIME</i>	<i>5</i>	<i>2</i>
<u>EXPENDITURES</u>		
	<i>\$</i>	<i>\$</i>
<i>WAGES</i>	<i>94,300</i>	<i>53,200</i>
<i>FR. BENEFITS</i>	<i>18,860</i>	<i>10,640</i>
<i>MAT. & SUPPLIES</i>	<i>6,400</i>	<i>6,900</i>
<i>PURCHASED SERVICES & RENTS</i>	<i>6,500</i>	<i>7,400</i>
<i>CAPITAL ACQ.</i>		
<i>DEBT CHARGES</i>		
<i>TRANSFERS</i>	<i>9,000</i>	<i>9,000</i>
<i>OTHER EXPENSES</i>	<i>1,800</i>	<i>2,200</i>
	<i>136,860</i>	<i>89,340</i>
<i>LESS: RECOVERIES</i>	<i>4,600</i>	<i>3,200</i>
<i>NET EXPENDITURES</i>	<i>132,260</i>	<i>86,140</i>

ALTERNATIVES:

- Collection without stipulation that plastic bags be used would require 3 man crews costing an additional \$24,600.*
- Contract with private contractor for urban pickup estimated at \$90,000.*

CHANGES FROM EXISTING OPERATIONS:

- Reduce frequency of collection from twice to once weekly service.*
- Revision of route schedules to reduce extent of part-time help (savings \$4,500).*
- Termination of 4 full-time employees.*

CONSEQUENCES OF NOT FUNDING:

- Residents would be required to deliver refuse to dump sites.*
- Public health costs would rise.*

GENERAL COMMENTS:

- Assumes continuation of \$9,000 annually to "equipment replacement reserve".*
- Recoveries reduced due to provision of lower special services to commercial users.*

APPROACHES	PACKAGE	OVERALL
<i>This 1 of 3</i>	<i>\$ 86,140</i>	<i>\$ 86,140</i>
<i>Level 2 of 3</i>	<i>53,440</i>	<i>139,580</i>
<i>Level 3 of 3</i>	<i>8,200</i>	<i>147,780</i>

ACTIVITY		DEPARTMENT	DATE	LEVEL		
<i>Residential Refuse Collection</i>		<i>Public Works</i>	<i>12/2/78</i>	<i>2 of 3</i>		
PREPARED	APPROVED	SECTION	RANK	4	12	
<i>J. Abercrombie</i>	<i>A. Fritz</i>	<i>Sanitation</i>	BY	<i>JA</i>	<i>AF</i>	
PURPOSE OF ACTIVITY:		PERFORMANCE MEASURES		1977	1978	
<i>Collection of solid waste from individual households in urban areas and from four transfer stations in rural areas.</i>		<i>Number of homes served</i>		<i>3,670</i>	<i>3,740</i>	
		<i>Collections per week</i>		<i>2</i>	<i>2</i>	
		<i>Tons of refuse</i>		<i>7,340</i>	<i>7,700</i>	
		<i>Collection cost per home</i>		<i>\$36.03</i>	<i>\$37.32</i>	
DESCRIPTION OF ACTIVITY:		RESOURCES REQUIRED		1977 ACTUAL	1978 THIS PACKAGE	
<i>This level employs four 2 man crews to collect refuse twice per week in the more populated areas. Normal pickups are scheduled on a 4 day week basis. On Mondays, special pickups and maintenance of transfer stations. Service agreement with Sani-Services Ltd. to deliver 5 cu. yd. bins to dump site each Monday.</i>		<u>PERSONNEL</u>				
		<i>FULL-TIME</i>		<i>8</i>	<i>8</i>	
		<i>PART-TIME</i>		<i>5</i>	<i>4</i>	
		<u>EXPENDITURES</u>		<i>\$</i>	<i>\$</i>	
		<i>WAGES</i>		<i>94,300</i>	<i>99,400</i>	
		<i>FR. BENEFITS</i>		<i>18,000</i>	<i>19,880</i>	
		<i>MAT. & SUPPLIES</i>		<i>6,400</i>	<i>7,500</i>	
		<i>PURCHASED SERVICES & RENTS</i>		<i>6,500</i>	<i>7,000</i>	
		<i>CAPITAL ACQ.</i>				
		<i>DEBT CHARGES</i>				
		<i>TRANSFERS</i>		<i>9,000</i>	<i>9,000</i>	
		<i>OTHER EXPENSES</i>		<i>1,800</i>	<i>1,800</i>	
				<i>136,860</i>	<i>144,580</i>	
		<i>LESS: RECOVERIES</i>		<i>4,600</i>	<i>5,000</i>	
		<i>NET EXPENDITURES</i>		<i>132,260</i>	<i>139,580</i>	
ALTERNATIVES:		APPROACHES		PACKAGE	OVERALL	
<i>Contract with private contractor for urban pickup estimated at \$150,000.</i>		<i>Level 1 of 3</i>		<i>\$86,140</i>	<i>\$ 86,140</i>	
		<i>This 2 of 3</i>		<i>53,440</i>	<i>139,580</i>	
		<i>Level 3 of 3</i>		<i>8,200</i>	<i>147,780</i>	
CHANGES FROM EXISTING OPERATIONS:						
<i>1. Basically represents continuation of 1977 level of servicing.</i>						
<i>2. Revision of route schedules to reduce part-time help (savings \$1,500).</i>						
CONSEQUENCES OF NOT FUNDING:						
<i>1. Termination of 4 full-time employees.</i>						
<i>2. Recognition of reduced level of service which will result in an increase in ratepayer's complaints.</i>						
GENERAL COMMENTS:						
<i>1. Assumes continuation of \$9,000 annually to "equipment replacement reserve".</i>						
<i>2. Assumes slight increase in special services to commercial users and 8% increase in charges.</i>						

ACTIVITY		DEPARTMENT	DATE	LEVEL			
<i>Residential Refuse Collection</i>		<i>Public Works</i>	<i>12/2/78</i>	<i>3 of 3</i>			
PREPARED	APPROVED	SECTION	RANK	6	21		
<i>J. Abercrombie</i>	<i>A. Fritz</i>	<i>Sanitation</i>	BY	JA	AF		
PURPOSE OF ACTIVITY: <i>Collection of solid waste from individual households in urban areas and five transfer stations in rural area.</i>		PERFORMANCE MEASURES	1977	1978			
		<i>Number of homes served</i>	<i>3,670</i>	<i>3,740</i>			
		<i>Collection per week</i>	<i>2</i>	<i>2</i>			
		<i>Tons of refuse</i>	<i>7,340</i>	<i>7,800</i>			
		<i>Collection cost per home</i>	<i>\$36.03</i>	<i>\$39.51</i>			
DESCRIPTION OF ACTIVITY: <i>This level utilizes four 2 man crews to collect refuse twice per week in the urban areas. Normal pickups are scheduled on a 4 day week basis. On Mondays special pickups and maintenance of transfer stations. Service agreement with Sani-Services Ltd. delivers 5 cu. yd. bins to dump site each Monday.</i>		RESOURCES REQUIRED	1977 ACTUAL	1978 THIS PACKAGE			
		<u>PERSONNEL</u>					
		<i>FULL-TIME</i>		<i>8</i>	<i>8</i>		
		<i>PART-TIME</i>		<i>5</i>	<i>4</i>		
		<u>EXPENDITURES</u>		\$	\$		
		<i>WAGES</i>		<i>94,300</i>	<i>99,400</i>		
		<i>FR. BENEFITS</i>		<i>18,860</i>	<i>19,880</i>		
		<i>MAT. & SUPPLIES</i>		<i>6,400</i>	<i>7,700</i>		
		<i>PURCHASED SERVICES & RENTS</i>		<i>6,500</i>	<i>8,800</i>		
		<i>CAPITAL ACQ.</i>					
		<i>DEBT CHARGES</i>					
		<i>TRANSFERS</i>		<i>9,000</i>	<i>15,000</i>		
		<i>OTHER EXPENSES</i>		<i>1,800</i>	<i>2,000</i>		
		<i>136,860</i>	<i>152,780</i>				
<i>LESS: RECOVERIES</i>		<i>4,600</i>	<i>5,000</i>				
<i>NET EXPENDITURES</i>		<i>132,260</i>	<i>147,780</i>				
ALTERNATIVES: <i>Contracted transfer station pickups could be performed by municipal staff at a cost of \$9,000 (additional \$200 to present costs).</i>		APPROACHES	PACKAGE	OVERALL			
		<i>Level 1 of 3</i>	<i>\$86,140</i>	<i>\$ 86,140</i>			
		<i>Level 2 of 3</i>	<i>53,440</i>	<i>139,580</i>			
		<i>This 3 of 3</i>	<i>8,200</i>	<i>147,780</i>			
CHANGES FROM EXISTING OPERATIONS: <ol style="list-style-type: none"> <i>One additional transfer site established to improve rural service (additional cost \$1,800).</i> <i>Provision for "equipment replacement reserve" increased by \$6,000 to accommodate conversion to garbage packer vehicles.</i> 		GENERAL COMMENTS:					
		<i>While discontinuance of Sani-Service contract is slightly more costly for 1978, on a five-year amortization of capital costs the municipality should save approximately \$5,000.</i>					
		CONSEQUENCES OF NOT FUNDING:					
		<ol style="list-style-type: none"> <i>Continued inconvenience to rural residents because of limited capacity at transfer stations.</i> <i>Conversion from flatbed trucks is necessary in order to minimize labour and transportation costs in future years.</i> 					

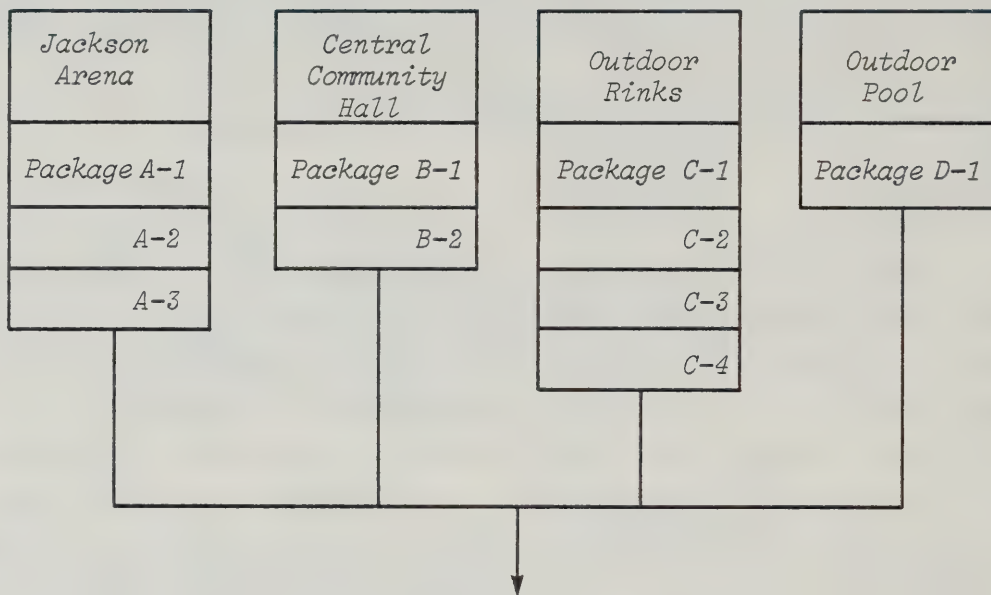
Ranking of Decision Packages

Once the decision packages have been developed by various managers, the ranking process begins. The ranking process is the sequential listing of decision packages in order of decreasing benefit or importance so that council can later determine both what amount of funding should be approved and which packages the municipality can afford to do without.

The initial ranking of packages occurs at the organizational level where they are developed in order to allow each manager to evaluate the relative importance of his own activities. It also establishes a commitment to a certain output level and provides a basis for subsequent evaluation of effectiveness. A schematic illustration of the ranking process performed by a line manager is highlighted on page 22 . The decision packages, with their tentative ranking form, are then forwarded to the next level of management for review, revision of rankings and overall consolidation of the rankings according to predetermined cutoff levels established and how these senior managers see the broader municipal priority values (priorities will be somewhat different at each level). The successive aggregations by higher management levels will continue until each department's decision packages are ranked completely in descending order of priority. A sample consolidated "Ranking Summary Report" is illustrated on page 24.

In some municipalities, the process of merging decision packages will continue to major functional activities (i.e.: public works) or to levels that coincide with the jurisdictional responsibilities of standing committees. The actual arrangement will depend largely on the organizational structure within each municipality. The main consideration, however, is that as the ranking process begins to involve

CONSOLIDATION OF DECISION
 PACKAGES BY THE ARENA MANAGER*



CONSOLIDATED
 RANKING

Package A-1
B-1
A-2
C-1
D-1
C-2
C-3
A-3
B-2
C-4

PRELIMINARY
 BUDGET LIMIT



* For organizational structure of Parks and Recreation Department see page 15.

those not intimately familiar with all aspects of a decision package, the needed expertise warrants a committee or task force approach. The process of forwarding the consolidated and reranked decision packages to the next organizational level is repeated until all the decision packages are in a single sequence. Since the most essential decision packages will emerge toward the top of the final ranking and the least essential packages will gravitate toward the bottom, most of the analysis will be directed to the packages at the margin of available resources.

Resource Allocation

With the completion of prioritization by staff and committees, the ranked decision packages can now be submitted to council for resource allocation. Council must now introduce a twofold approach, which is to consider the ranking of activities developed and at the same time consider the estimated revenues available for the forthcoming year. The process at this point is to go through a series of iterations to arrive at a match between the cumulative amount required for those decision packages considered essential and the total resources available. In practice, there is seldom much argument over the minimum level of effort especially where these are legally required or are fundamental functions. For example, you cannot dispense with the minimum tax collection activity package regardless of it being categorized as number 101 or as number 3 on the ranked listing.

The amount of review effort at this stage will largely depend on the extent of council involvement in earlier proceedings and the magnitude of the unfunded shortfall. What tends to become relevant is the order of priority just above and below the prospective cutoff point. Those packages above the cutoff point become reflected in the

RANKING SUMMARY REPORT				1977 ACTUAL		1978 ESTIMATES		
Rank	Department	Activity	Complement		Gross Spending	Cumul. Total	Gross Spending	Cumul. Total
			1977	1978				
7		Totals brought forward	35	37	-	365,860	-	325,420
8	Public Works	Residential Refuse Collection (1 of 3)	8	4	136,860	502,720	89,340	414,760
9	Public Works	Snow Control (2 of 3)	2	2	26,420	529,140	24,950	439,710
10	Public Works	General Roadway Maintenance (2 of 4)	-	-	17,680	546,820	28,730	468,440
11	Public Works	Surface Roadway Repairs (3 of 3)	-	-	-	546,820	15,760	484,200
12	Public Works	Residential Refuse Collection (2 of 3)	-	4	-	546,820	53,440	537,640
13	Public Works	Asphalt Surface Leveling (2 of 3)	1	1	14,750	561,570	18,315	555,955
14	Public Works	Dust Control (2 of 3)	-	-	-	561,570	19,750	575,705
15	Public Works	Street Cleaning (2 of 3)	-	-	-	561,570	14,220	589,925
16	Public Works	Sidewalk Repairs (1 of 3)	2	2	28,750	590,320	29,945	619,870
17	Public Works	Roadside Weed Control (2 of 3)	1	1	14,840	605,160	15,810	635,680
18	Public Works	Roadside Drainage (2 of 3)	-	-	-	605,160	9,780	645,460
19	Public Works	Yard Maintenance (3 of 3)	-	-	-	605,160	6,800	652,260
20	Public Works	Tree Maintenance (3 of 3)	-	-	-	605,160	4,640	656,900
21	Public Works	Residential Refuse Collection (3 of 3)	-	-	-	605,160	8,200	665,100
22	Public Works	Snow Control (3 of 3)	-	-	-	605,160	13,940	679,040
23	Public Works	General Roadway Maintenance (3 of 4)	-	-	-	605,160	16,640	695,680
24	Public Works	Dust Control (3 of 3)	-	-	-	605,160	10,100	705,780
25	Public Works	Sidewalk Repairs (2 of 3)	2	-	28,750	633,910	7,320	713,100

Department or Committee: Public Works Comm.

Prepared by: E. Norton

Date: 15/2/78

Page 2 of 4

approved operating budget and those just below the cutoff point become the expansion levels to be considered if additional funds become available during the year.

Once the decision packages are approved, the managers can then finalize the operating budget in a format that coincides with the financial accounting system of the municipality. The approved decision packages provide a means whereby actual operations can be measured against the performance levels committed rather than just traditional monetary limitations.

LIMITATIONS

All management techniques have their good and bad features, and zero-base budgeting is no exception. In order to put its strengths in perspective, its weaknesses should first be considered.

- Ordinarily zero-base budgeting requires a greater amount of paperwork than that associated with conventional budgeting systems.
- Developing and evaluating decision packages takes a great deal of time.
- Many staff members may feel threatened by its attempt to evaluate the effectiveness of their programs.
- While it facilitates performance auditing, it does not overcome the difficulty of determining relevant output measures.
- Its installation may be interpreted as implying criticism of existing budget operations.
- A considerable amount of creative work is necessary to devise a zero-base system that will be practical for the organization. Most municipalities will require consultants in an advisory capacity the first year of implementation.
- Political or behavioral characteristics may offset the positive benefits available. Zero-base budgeting was developed originally in the

private sector where the corporate objectives can usually be defined more simply.

- There is a possibility of gamesmanship such as attaching a low ranking value to an activity to camouflage inefficiencies.
- It may require changes in the accounting system which might cause a loss in continuity and comparability with prior years.
- As other budgeting processes, it can become quite a mechanical exercise. The interest in this innovation can dissipate with the result that the continued pursuit of new techniques and benefits are short-lived.

BENEFITS

The final verdict is not yet available, but at this point the following appear to represent the inherent advantages associated with zero-base budgeting.

- Planning, budgeting and operational decision-making is combined into one systematic process.
- It offers the capability to modify goals and expectations quickly and rationally to correspond to a realistic and affordable plan of operation. Changes in funding levels require only an examination of marginal proposals and not establishment of a new budget.
- By examining alternate ways of accomplishing objectives, it makes it possible for policymakers to reallocate resources from less effective, lower priority activities to higher priority activities.
- It gives managers at all levels (and council) a greater insight into the role of their function and its interrelationship within the overall municipal structure. It provides a practical method of instituting an organization-wide review of programs and priorities.
- It provides activity information to councilors in an understandable form so that they can appreciate the complexities of program

operations. It eliminates the practice of resorting to arbitrary across-the-board budget reductions.

- It stimulates thinking at the lower management levels and generates good ideas from those responsible for the day-to-day operations.
- Its analytical approach forces managers to identify inefficient or obsolete routines and facilitates the introduction of new programs if these are considered more beneficial to the organization's established goals.
- The ranking process brings the management team together and generates interaction focusing on results and resource allocation decisions.
- Funding requests are centred around services rendered and value received instead of being limited to accounting inputs as salaries, supplies and other expense items.
- Its documentation process provides evidence of the elements considered to arrive at the final budget.
- Involvement of supervisory staff at all levels establishes a sense of commitment throughout the organization to attain the predetermined goals.
- It provides statistical and financial data that can be utilized to measure both performance and cost.
- It permits a municipality to respond quickly and effectively if actual expenditures begin to exceed available funds.
- While preferable to do so, it does not have to be applied throughout an organization. It can be applied on a selective basis to those areas where management is most concerned.
- It can be continued in subsequent years in a more abbreviated form without loss of the knowledge and meaning of zero-base budgeting.

APPLICATION TO SMALL MUNICIPALITIES

Zero-base budgeting has tended to be implemented in larger government organizations because of economies of scale that arise, their availability of staff resources, the complexities of managing their operations, and the difficulties associated with achieving a good understanding of all the functions performed. Nevertheless, this does not rule out the possibility of smaller municipalities extracting selected features of zero-base budgeting and integrating them with their conventional budgeting approach. For example, in order to establish greater emphasis on output a municipality might initially request each department head to breakdown his estimates into self-contained operating units and identify the purpose and objective of each cost centre.

In a subsequent year, the narrative information may be expanded to indicate alternative methods of operation or of providing the service. A later innovation might be the production of performance standards (unit quantification of output) to be later compared to actual output and dollars expended.

In smaller municipalities, the magnitude of controllable costs and the degree of flexibility may never justify devising a layered structure of ranking to eventually produce an overall corporate ranking. However, having each manager analyze in detail his own departmental operation as part of the budgetary process, and use a cost/benefit approach to justify expenditure increase requests, can be beneficial.

CONCLUSION

The zero-base concept is neither complex or esoteric. Indeed, it is an extremely logical approach which correlates optimum operations with levels of affordability. A council dissatisfied with its budgeting system, or uneasy about the magnitude of some of its programs, will find that zero-base budgeting can provide a structural method of addressing those concerns.

Zero-base budgeting can prove very worthwhile for those organizations where there is a desire to make the system work and a willingness to spend the necessary time and effort. It can reinforce managers in their respective efforts and can support them in their pursuit of satisfying the municipality's objectives. On the other hand, it is not a difficult system to subvert if a manager puts his mind to it. In the absence of firm top management leadership it can be a complete waste of time. The process can be easily undermined if staff routinely claim that their operations cannot be modified and are unwilling to carefully look at their operations. For these reasons, the suitability and potential benefit of zero-base budgeting must be evaluated from the standpoint of what it will be able to do for your municipality, its managers, and the management process. While a number of governments are turning to zero-base budgeting as a means of executing their programs of financial restraint, don't overlook its other attractive benefits.

A Sample of ZBB Literature

Articles:

Administrative Management

McGinnis, James F. "Pluses and Minuses of Zero-Base Budgeting", Volume 37, No. 9, September, 1976.

C A Magazine

MacFarlane, John A. "Zero-Base Budgeting in Action", Volume 109, No. 12, December, 1976.

McCandless, Henry E. "The Behavioural Side of Zero-Base Budgeting", Volume 111, No. 11, November, 1978.

CGA Magazine

Bergeron, Pierre G. "The Human Side of Zero-Base Budgeting", Volume 13, No. 3, March, 1979.

Civic Public Works

McFarland, Webb H. "Zero-Base Budgeting In Hamilton" (Excerpts from presentation to Association of Municipal Clerks and Treasurers of Ontario annual conference), Volume 30, No. 8, August, 1978.

Knight, Henry C. "How ZBB Can Help Councillors", Volume 30, No. 11, November, 1978.

"ZBB -- How It Can Support Elected Representatives", Volume 30, No. 12, December, 1978.

Galley, Thomas "Zero-Base Budgeting Can Be A Powerful Tool" (Address to the American Public Works Association annual meeting of Ontario Chapter), Volume 31, No. 3, March, 1979; Volume 31, No. 4, April, 1979.

Cost and Management (R.I.A.)

- Roehm, Harper A., and Castellano, Joseph F. "Zero-Base Budgeting: A Comparison With Traditional Budgeting", Volume 51, No. 6, November-December, 1977.
- Tourangeau, Kevin W. "Zero-Base Budgeting: The New Management Process", Volume 51, No. 6, November-December, 1977.
- "Operating A Zero-Base Budgeting Program", Volume 52, No. 1, January-February, 1978.
- Knight, Henry C. "Who's Afraid of ZBB", Volume 52, No. 5, September-October, 1978.

Current Municipal Problems

- Belsito, Floyd G. "A City's First Year Experience", (City of Huntington Beach, Calif.), Volume 5, No. 2, Fall, 1978.

Governmental Finance (M.F.O.A.)

- Singleton, David W. "Zero-Base Budgeting In Wilmington, Delaware", Volume 5, No. 3, August, 1976.

Harvard Business Review

- Pyhrr, Peter A. "Zero-Base Budgeting", Volume 48, No. 6, November-December, 1970.
- Suver, James D. and Brown, Ray L. "Where Does Zero-Base Budgeting Work?", Volume 55, No. 6, November-December, 1977.

Management World

- Wright, Norman H. "Zero-Base Planning and Budgeting", Volume 5, No. 10, October, 1976.
- "Zero-Base Budgeting--Decision Packages", Volume 5, No. 12, December, 1976.
- "Zero-Base Budgeting--The Ranking Process", Volume 6, No. 2, February, 1977.

"Cost Reduction Zero-Base Planning and Budgeting", Volume 6, No. 4, April, 1977.

Public Administration Review

Pyhrr, Peter A.

"The Zero-Base Approach To Government Budgeting", Volume 37, No. 1, January-February, 1977.

Books:

Pyhrr, Peter A.

"Zero-Base Budgeting: A Practical Management Tool For Evaluating Expenses", New York, N.Y.: John Wiley & Sons, 1973. 231 pages, ISBN 0-471-70234X.

For the ultimate authority on ZBB, one should review this publication. Mr. Pyhrr's 1973 book is the seminal document in this field. The author, using a cook-book approach, devotes the bulk of his book to "How to make zero-base budgeting work". He draws on his Texas Instrument application where he first employed it, and the now famous Georgia State application which he directed.

Cheek, Logan M.

"Zero-Base Budgeting Comes of Age", New York, N.Y.: Amacom, 1977. 314 pages, ISBN 0-8144-5442-9.

As a reference book, this publication is equivalent (if not better because of experiences drawn from later applications) to Peter Pyhrr's publication. Very comprehensive from the standpoint of implementing zero-base budgeting. He discusses how to organize the process, alternative methods for ranking decision packages, integrating the process with other planning processes, top management's role, and how to overcome concerns during implementation. Considerable coverage of sample decision package and ranking forms.

Pattillo, James W.

"Zero-Base Budgeting: A Planning, Resource Allocation and Control Tool", New York, N.Y.: National Association of Accountants, 1977, 83 pages.

For a concise overview of zero-base budgeting, this publication is exceptional. The nominal cost of this publication (\$5.95 U.S.) and its non-technical language makes it a worthwhile personal reference book for both councillors and senior staff. One section deals with decision packages and how they might be determined. Another section discusses a system for ranking packages. The last section presents suggestions as to how the system might be implemented.

Tourangeau, Kevin W.

"Zero-Base Budgeting: An Operating Manual For Corporations and Governments", Toronto, Ontario: Touraine Publishing Corporation, 1977, 157 pages.

One must recognize that this book is an operating Manual written for a hypothetical government corporation. It assumes the reader is familiar with the conceptual theories of ZBB, such as what it is meant to achieve. It is a how to workbook in the form of an operating manual. This publication communicates through example rather than theoretical discussions.

Wholely, Joseph S.

"Zero-Base Budgeting and Program Evaluation", Lexington, Mass.: D.C. Heath and Company, 1978, 157 pages, ISBN 0-669-01730-2.

Demonstrates a simplified form of zero-base budgeting based on applications for the County of Arlington (Virginia) and the Washington Metropolitan Area Transit Authority. Recommended for those having considerable background knowledge of conventional zero-base approaches and interested in adopting a modified version requiring less paperwork and staff time.

Selected Comments Regarding First
Year Experiences with Z.B.B.

U.S. Federal Government

(Comments by George H. Strauss, Chief of Resources Systems in the Office of Management and Budget - from the Arthur Young Journal)

"Most agencies did have trouble with the identification of minimum levels. In some agencies, the minimum levels were so close to the current level that no attempt was made to consider the possibility of a lower program level. In other cases minimum levels were arbitrarily set well below realistic levels.

In developing detailed instructions, some agencies required that the minimum levels be no more than a certain percentage (generally 75 to 80 percent) of the current year's funding level. This use of percentages does have some practical advantages. It saves time, and helps to ensure that managers at least consider the effects of a significant reduction from their current program level.

The use of percentages also has drawbacks, however. It tends to discourage managers from doing the basic analysis of existing programs that's really vital to ZBB, and it may also result in minimums that are well below the level of feasibility."

State of Georgia

Extract from 1976 speech by Jimmy Carter:

"I don't want to mislead you and leave the impression that implementing zero-base budgeting will create instant miracles in the Federal Government. In Georgia, its impact during my incumbency was quite subtle, but nevertheless real, in making basic changes in our government's operation. No doubt it will continue to generate improvements in the years ahead."

City of Charlottesville, Virginia

(Comments by Robert Stripling, Assistant City Manager - from Municipal Finance Officer's Newsletter, July 16, 1977).

"Previously, the city had used a Management by Objectives and program budgeting format, which, while workable, seemed

more suited for program expansion than program reduction. To ease the transition to ZBB, the first year of implementation was confined to the city's five largest departments: public works, parks and recreation, social services, fire and police. While ZBB did not produce substantial cost savings for Charlottesville this year, it was considered a success because the process gave all levels of management a better understanding of city programs and the impact of reduced expenditures on these programs. All city departments will use ZBB next year."

City of Wilmington, Delaware.

(Comments by David Singleton, Director of Program Analysis Division - from Governmental Finance, August, 1976).

"Initially many of the Councilmen approached the budget much as they had approached past budgets. Most of the discussion concerned the incremental changes to line-items. However, as the hearings proceeded, greater and greater attention focused on ZBB considerations. The rationale for a particular ranking, for example, was discussed more and more frequently. Much interest centered on the federal and state grant funds - information which the Council had never before had available in a systematic manner. There was also steadily increasing discussion of program measures and the marginal costs associated with a higher level of service."

City of Guelph, Ontario.

(Comments by Milt R. Sather, Treasurer, to A.M.C.T. - Advisory Committee of Municipal Treasurers, May, 1979).

"My post analysis of Z.B.B. is that as a budget tool in the financial sense only, it is a reasonable weapon against increased expenditures. However, the end financial results could probably be obtained by any number of approaches. For example, our mill rate increase of 4.2% could have been obtained through the old traditional incremental method. At some point close to the end of budget deliberations, the City would simply slash across the board, most if not all budgets to reach the desired level of spending. However, one need not be an expert in management to know that such an attack is not only irresponsible, it is foolhardy.

What Z.B.B. did for Guelph, was to permit the reallocation of funds - the reduction or elimination of programs - the expansion of others in a logical systematic manner. The

result was a reasonable increase in the mill rate and the maintenance of levels of service which compliment both past performances and citizen's expectations for the future as well."

City of Hamilton, Ontario.

(Comments by Webb H. Mc Farland, Treasurer and Commissioner of Finance, to the A.M.C.T. Annual Conference, June, 1978).

"Not only was a reduction in the mill rate realized, the Z.B.B. system enabled officials to reallocate some of the City funds to more productive areas. For example, 20 current level packages were not funded and 14 expansion packages were approved."

"The Board of Control recommended to Council that packages No. 1 to No. 351 in the amount of \$68.8 million be funded and that packages No. 352 to No. 440 not be funded."

City of Peterborough, Ontario.

(Comments by Edward I. De Haan, Deputy Treasurer).

"In an efficient operation such as ours Z.B.B. is not an easy tool to reduce taxes, unless the Public is prepared to accept a lower level of service. It does reveal to City Council and the Public the high level of service presently provided and the alternatives available with resulting cost-savings. We verified through this process that we have been operating a lean operation, we have found economies that can be utilized immediately and others we can implement in 1980. There is no doubt that we can improve on the process, and we intend to do so during the next two years. Budgets will be requested in the fall of 1979 for the two year period 1980 and 1981 to reflect the impact of recommended changes resulting from the Budget Review."

Borough of Scarborough, Ontario.

(Comments by Thomas Galley, Director of Administration to the 1979 Annual Meeting of the Ontario Chapter, American Public Works Association).

"The modification we made to the zero base approach to budgeting was that instead of building a level of service beginning with the lowest possible level at which the program

would continue to be viable we agreed that it should be 90 percent of the level of service provided in the previous year.

That is absolutely foreign to zero base theorists who initially look at 40 percent.

The reason we have done this is that when we examined zero base applications we found that almost all of the packages that were under 80 or 85 percent were always approved anyway, so there seemed no reason especially in the first year of introducing this new system, to incur the cost of developing alternative levels of service at that lower range when the chances were that it would be approved anyway.

We decided, for the first year at least, to do it at 90 percent and thereby eliminate much of the frustration, anxiety and paperwork. In subsequent years there is no reason why a lower level cannot be adopted."

City of Thunder Bay, Ontario.

(Extracts from Evaluation Report, April 17, 1979, prepared by J. G. Rapino, Director of Corporate Planning and Development).

"The evaluation process also included an attempt to do an analysis of the increased amount of time required to prepare the 1979 Operating Budget versus the 1978 Budget."

"This analysis showed that an additional 6,300 manhours (10,400 manhours versus 4,100 manhours) were spent on the 1979 budget which involves \$71.5 million of gross expenditures."

"This analysis must be qualified somewhat because of the difficulty Managers had in estimating their time involvement a year ago in 1978. However, the consistency of (their) responses which indicate that 1979 required about twice as much time as 1978 suggests that the estimates for 1978 and 1979 are reasonable.

An additional qualifier must be added because of the difficulty in separating the management tasks required by the Budget process from the general management duties. A manager is responsible for the detailed planning and analysis of his operation whether or not it is part of the budget process. In 1978, these tasks were not so much a part of the budget process but were done by managers as separate exercises."

If you require additional information on this subject, please contact your local office of the Field Services Branch, Local Government Division of the Ministry of Intergovernmental Affairs.

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